

## Internal Revenue Service, Treasury

## § 1.41-5A

which B is to perform research that would, but for section 41(d)(3)(H), be qualified research of B. The agreement calls for A to pay B \$120x, regardless of the outcome of the research. In 1982, A makes full payment of \$120x under the contract. B performs all the research, and B pays all the expenses connected with the research, as follows:

In-house research expenses .....	\$100x
Outside research:	
(Amount B paid to third parties for research, 65 percent of which (\$26x) is treated as a contract research expense of B) .....	40x
Overhead and other expenses .....	10x
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Total .....	150x

If B has no rights to the research, B is fully funded. Alternatively, assume that B retains the right to use the results of the research in carrying on B's business. Of B's otherwise qualified research expenses of \$126x + \$26x, \$120x is treated as funded by A. Thus \$6x (\$126x - \$120x) is treated as a qualified research expense of B. However, if B establishes the facts required under paragraph (d)(3) of this section, B can allocate the funding pro rata to nonqualified and otherwise qualified research expenses. Thus \$100.8x (\$120x (\$126x/\$150x)) would be allocated to otherwise qualified research expenses. B's qualified research expenses would be \$25.2x (\$126x - \$100.8x). For purposes of the following examples (2), (3) and (4) assume that B retains substantial rights to use the results of the research in carrying on B's business.

*Example 2.* The facts are the same as in example (1) (assuming that B retains the right to use the results of the research in carrying on B's business) except that, although A makes full payment of \$120x during 1982, B does not perform the research or pay the associated expenses until 1983. The computations are unchanged. However, B's qualified research expenses determined in example (1) are qualified research expenses during 1983.

*Example 3.* The facts are the same as in example (1) (assuming that B retains the right to use the results of the research in carrying on B's business) except that, although B performs the research and pays the associated expenses during 1982, A does not pay the \$120x until 1983. The computations are unchanged and the amount determined in example (1) is a qualified research expense of B during 1982.

*Example 4.* The facts are the same as in example (1) (assuming that B retains the right to use the results of the research in carrying on B's business) except that, instead of agreeing to pay B \$120x, A agrees to pay \$100x regardless of the outcome and an additional \$20x only if B's research produces a useful product. B's research produces a useful product and A pays B \$120x during 1982.

The \$20x payment that is conditional on the success of the research is not treated as funding. Assuming that B establishes to the satisfaction of the district director the actual research expenses, B can allocate the funding to nonqualified and otherwise qualified research expenses. Thus \$84x (\$100x (\$126x/\$150x)) would be allocated to otherwise qualified research expenses. B's qualified research expenses would be \$42x (\$126x - \$84x).

*Example 5.* C enters into a contract with D, a cash-method taxpayer using the calendar year as its taxable year, under which D is to perform research in which both C and D will have substantial rights. C agrees to reimburse D for 80 percent of D's expenses for the research. D performs part of the research in 1982 and the rest in 1983. At the time that D files its return for 1982, D is unable to determine the extent to which the research is funded under the provisions of this paragraph. Under these circumstances, D may not treat any of the expenses paid by D for this research during 1982 as qualified research expenses on its 1982 return. When the project is complete and D can determine the extent of funding, D should file an amended return for 1982 to take into account any qualified research expense for 1982.

[T.D. 8251, 54 FR 21204, May 17, 1989. Redesignated and amended by T.D. 8930, 66 FR 295, Jan. 3, 2001]

#### § 1.41-5 Basic research for taxable years beginning after December 31, 1986. [Reserved]

#### § 1.41-5A Basic research for taxable years beginning before January 1, 1987.

(a) *In general.* The amount expended for basic research within the meaning of section 30(e) (before amended by the Tax Reform Act of 1986) equals the sum of money plus the taxpayer's basis in tangible property (other than land) transferred for use in the performance of basic research.

(b) *Trade or business requirement.* Any amount treated as a contract research expense under section 30(e) (before amendment by the Tax Reform Act of 1986) shall be deemed to have been paid or incurred in carrying on a trade or business, if the corporation that paid or incurred the expenses is actually engaged in carrying on some trade or business.

(c) *Prepaid amounts—(1) In general.* If any basic research expense paid or incurred during any taxable year is attributable to research to be conducted after the close of such taxable year, the

expense so attributable shall be treated for purposes of section 30(b)(1)(B) (before amendment by the Tax Reform Act of 1986) as paid or incurred during the period in which the basic research is conducted.

(2) *Transfers of property.* In the case of transfers of property to be used in the performance of basic research, the research in which that property is to be used shall be considered to be conducted ratably over a period beginning on the day the property is first so used and continuing for the number of years provided with respect to property of that class under section 168(c)(2) (before amendment by the Tax Reform Act of 1986). For example, if an item of property which is 3-year property under section 168(c) is transferred to a university for basic research on January 12, 1983, and is first so used by the university on March 1, 1983, then the research in which that property is used is considered to be conducted ratably from March 1, 1983, through February 28, 1986.

(d) *Written research agreement*—(1) *In general.* A written research agreement must be entered into prior to the performance of the basic research.

(2) *Agreement between a corporation and a qualified organization after June 30, 1983*—(i) *In general.* A written research agreement between a corporation and a qualified organization (including a qualified fund) entered into after June 30, 1983, shall provide that the organization shall inform the corporation within 60 days after the close of each taxable year of the corporation what amount of funds provided by the corporation pursuant to the agreement was expended on basic research during the taxable year of the corporation. In determining amounts expended on basic research, the qualified organization shall take into account the exclusions specified in section 30(e)(3) (before amendment by the Tax Reform Act of 1986) and in paragraph (e) of this section.

(ii) *Transfers of property.* In the case of transfers of property to be used in basic research, the agreement shall provide that substantially all use of the property is to be for basic research, as defined in section 30(e)(3) (before

amendment by the Tax Reform Act of 1986).

(3) *Agreement between a qualified fund and a qualified educational organization after June 30, 1983.* A written research agreement between a qualified fund and a qualified educational organization (see section 30(e)(4)(B)(iii) (before amendment by the Tax Reform Act of 1986)) entered into after June 30, 1983, shall provide that the qualified educational organization shall furnish sufficient information to the qualified fund to enable the qualified fund to comply with the written research agreements it has entered into with grantor corporations, including the requirement set forth in paragraph (d)(2) of this section.

(e) *Exclusions*—(1) *Research conducted outside the United States.* If a taxpayer pays or incurs an amount for basic research to be performed partly within the United States and partly without, only 65 percent of the portion of the amount attributable to research performed within the United States can be treated as a contract research expense (even if 80 percent or more of the contract amount was for basic research performed in the United States).

(2) *Research in the social sciences or humanities.* Basic research does not include research in the social sciences or humanities, within the meaning of § 1.41-4A(c).

(f) *Procedure for making an election to be treated as a qualified fund.* In order to make an election to be treated as a qualified fund within the meaning of section 30(e)(4)(B)(iii) (before amendment by the Tax Reform Act of 1986) or as an organization described in section 41(e)(6)(D), the organization shall file with the Internal Revenue Service center with which it files its annual return a statement that—

(1) Sets out the name, address, and taxpayer identification number of the electing organization (the “taxpayer”) and of the organization that established and maintains the electing organization (the “controlling organization”),

(2) Identifies the election as an election under section 41(e)(6)(D) of the Code,

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(3) Affirms that the controlling organization and the taxpayer are section 501(c)(3) organizations,

(4) Provides that the taxpayer elects to be treated as a private foundation for all Code purposes other than section 4940,

(5) Affirms that the taxpayer satisfies the requirement of section 41(e)(6)(D)(iii), and

(6) Specifies the date on which the election is to become effective.

If an election to be treated as a qualified fund is filed before February 1, 1982, the election may be made effective as of any date after June 30, 1981, and before January 1, 1986. If an election is filed on or after February 1, 1982, the election may be made effective as of any date on or after the date on which the election is filed.

[T.D. 8251, 54 FR 21204, May 17, 1989. Redesignated and amended by T.D. 8930, 66 FR 295, Jan. 3, 2001]

### § 1.41-6 Aggregation of expenditures.

(a) *Controlled group of corporations; trades or businesses under common control*—(1) *In general.* In determining the amount of research credit allowed with respect to a trade or business that at the end of its taxable year is a member of a controlled group of corporations or a member of a group of trades or businesses under common control, all members of the group are treated as a single taxpayer and the credit (if any) allowed to the member is determined on the basis of its proportionate share (if any) of the increase in qualified research expenses of the aggregated group.

(2) *Definition of trade or business.* For purposes of this section, a trade or business is a sole proprietorship, a partnership, a trust, an estate, or a corporation that is carrying on a trade or business (within the meaning of section 162). For purposes of this section, any corporation that is a member of a commonly controlled group shall be deemed to be carrying on a trade or business if any other member of that group is carrying on any trade or business.

(3) *Determination of common control.* For rules for determining whether trades or businesses are under common control, see paragraphs (b) through (g)

of § 1.52-1 except that the words “singly or” in § 1.52-1(d)(1)(i) shall be treated as deleted.

(4) *Examples.* The following examples illustrate provisions of this paragraph.

*Example 1.* (i) *Facts.* A controlled group of four corporations (all of which are calendar-year taxpayers) had qualified research expenses (“research expenses”) during the base period and taxable year as follows:

Corporation	Base period (average)	Taxable year	Change
A .....	\$60	\$40	(\$20)
B .....	10	15	5
C .....	30	70	40
D .....	15	25	10

(ii) *Total credit.* Because the research expenses of the four corporations are treated as if made by one taxpayer, the total amount of incremental expenses eligible for the credit is \$35 (\$55 increase attributable to B, C, and D less \$20 decrease attributable to A). The total amount of credit allowable to members of the group is 20% of the incremental amount or \$7.00.

(iii) *Allocation of credit.* No amount of credit is allocated to A since A’s research expenses did not increase in the taxable year. The \$7.00 credit is allocated to B, C, and D, the members of the group that increased their research expenses. This allocation is made on the basis of the ratio of each corporation’s increase in its research expenses to the sum of increases in those expenses. Inasmuch as the total increase made by those members of the group whose research expenses rose (B, C, and D) was \$55, B’s share of the \$7.00 credit is 5/55; C’s share is 40/55; and D’s share is 10/55.

*Example 2.* The facts are the same as in example (1) except that A had zero research expenses in the taxable year. Thus, the controlled group had a decrease rather than an increase in aggregate research expenses. Accordingly, no amount of credit is allowable to any member of the group even though B, C, and D actually increased their research expenses in comparison with their own base period expenses.

(b) *Minimum base period research expenses.* For purposes of this section, the rule in section 41(c)(3) (pertaining to minimum base period research expenses) shall be applied only to the aggregate amount of base period research expenses. See the treatment of corporation C in example (1) of paragraph (a)(4) of this section.